STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	:	
	:	**Docket No. 11-0280**
Proposed General Increase in Rates for Gas Service	:	
	:	**(cons.)**
The Peoples Gas Light and Coke Company	:	
	:	**Docket No. 11-0281**
Proposed General Increase in Rates for Gas Service	:	

BRIEF ON EXCEPTIONS OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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Table of Contents

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Now comes the Staff of the Illinois Commerce Commission ("Staff"), by and through its undersigned attorneys, and pursuant to Section 200.830 of the Commission's Rules of Practice, 83 Ill. Adm. Code Section 200.830, respectfully submits this Brief on Exceptions to the Proposed Order issued by the Administrative Law Judges ("ALJs") on November 3, 2011 ("Proposed Order" or "PO").

I. INTRODUCTION

A. Overview/Summary

North Shore Gas Company ("North Shore" or the "Company") and The Peoples Gas Light And Coke Company ("Peoples Gas" or the "Company") (collectively referred to as the "Companies') filed new tariff sheets on February 15, 2011 in which the Companies proposed general increase in their natural gas rates and other tariff changes. In general, the PO reviews the issues presented in this proceeding in a clear and concise manner, is well written, and reflects the positions taken by Staff, the Companies, and the numerous intervening parties. Although Staff supports many of the PO's conclusions, there are items to which Staff takes exception as set forth below.

II. TEST YEAR (Uncontested)

III. REVENUE REQUIREMENT

IV. RATE BASE

A. Overview

B. Uncontested Issues (All Subjects Relate to NS and PGL Unless Otherwise Noted)

C. Contested Issues

1. Plant (All Subjects Relate to NS and PGL Unless Otherwise Noted)

2. Materials and Supplies – Computation of Associated Accounts Payable

Staff disagrees with the PO's conclusion regarding accounts payable associated with materials and supplies inventory that GCI witness Mr. Morgan's methodology is more reasonable than Staff's methodology. PO, p. 18. Mr. Morgan's adjustment which the Utilities accepted and the PO adopts does not reflect the actual timing of payments as supported by the lead lag studies presented by the Companies. Staff's methodology reflects the actual timing. As Staff pointed out, the adjustment proposed by GCI witness Morgan assumes incorrectly that payment is made for materials and supplies purchases in 30 days. The lead lag study clearly supports the 42.44 days and 46.62 days for NS and PGL, respectively, for the timing of materials and supplies purchase payments, Staff Ex. 12.0 Corrected, p. 19, not 30 days. The PO's conclusion on this issue neglects to consider this significant evidence.

Staff proposes the following changes to page 18 of the PO's conclusion on this issue:

Proposed Modification

(PO, p. 18)

a. Commission Analysis and Conclusion

> The Utilities in their rebuttal testimony accepted GCI witness Mr. Morgan's adjustment with minor calculation corrections. Staff states that although Mr. Morgan's adjustment is an improvement over the Utilities' proposal, Staff's adjustment more accurately reflects the accounts payable balance for material and supplies inventory. <u>The Commission agrees with Staff that the record shows actual payments for materials and supplies inventory are made in 42.44 days and 46.62 days for NS and PGL, respectively. Thus, t</u>~~T~~he Commission finds ~~Mr. Morgan's~~ <u>Staff's</u> methodology to compute accounts payable associated with Materials and Supplies is reasonable and should be approved.

3. Gas in Storage – Computation of Associated Accounts Payable

Staff disagrees with the PO's conclusion accepting the Utilities' methodology regarding accounts payable associated with gas in storage inventory (PO, p. 21) because it does not reflect any amounts actually included in accounts payable during the test year. Staff's proposal for accounts payable associated with gas in storage should be approved because it more accurately reflects the reality of the accounts payable actually recorded by the Companies. Company Schedule F-8 clearly shows gas purchases are made every month of the year; therefore accounts payable associated with those gas purchases would also be reflected on the Companies books monthly, not just during those months in which a net increase in gas in storage occurs. Staff IB, p. 12. While Staff did consider the Companies arguments concerning LIFO inventory valuation, Staff's proposal for accounts payable is a more accurate representation than the alternative considered. Id., pp. 12-13.

Staff proposes the following changes to page 21 of the PO's conclusion on this issue:

Proposed Modification

(PO, p. 21)

Commission Analysis and Conclusion

The Commission accepts ~~the Utilities'~~ Staff's methodology for calculating accounts payable associated with Gas in Storage inventory. We find that Staff's discussion regarding the use of the lead lag study ~~that the Utilities' use of the LIFO accounting method for Gas in Storage~~ is instructive. ~~Nicor, which also uses the LIFO accounting method for Gas in Storage, proposed a similar methodology that went uncontested in its 2008 rate case. Further, in these dockets GCI witness Mr. Morgan who proposed a similar adjustment as Staff's regarding associated accounts payable for Gas in Storage withdrew his adjustment as inappropriate based upon the Utilities' use of the LIFO method.~~ Staff's methodology which accounts for actual purchases of gas in storage being made throughout the year is superior to the Utilities' methodology which ignores that fact. Staff's methodology reflects the accounts payable actually recorded on the Utilities books during each month of the test year whereas the Utilities methodology does not consider what is recorded on the books during the test year in those months where there is no net increase in gas in storage. We find Staff's methodology to be a more accurate reflection of what is recorded on the books throughout the test year. The Commission accepts Staff's ~~the Utilities'~~ methodology.

4. Cash Working Capital

a. Pass-Through Taxes

Staff takes exception to the PO's conclusion regarding the inclusion of pass-through taxes in the Companies' revenue lags to determine cash working capital ("CWC"). PO, p. 21. There are several flaws in the PO's analysis and conclusion regarding pass-through taxes.

First, the PO relies too strictly on maintaining the status quo from the previous rate case. The PO fails to recognize that the Commission is not bound by prior decisions. City of Chicago v. Illinois Commerce Commission, 133 Ill.App.3d 435, 440 (1st Dist. 1985) (citations omitted). ("Initially we note that the decisions of the Commission are not *res judicata*. The concept of public regulation includes of necessity the philosophy that the Commission shall have power to deal freely with each situation as it comes before it, regardless of how it may have dealt with a similar or same situation in a previous proceeding. Thus like other administrative agencies, the Commission is free to change its standards so long as such changes are not arbitrary and capricious."). The Commission must decide this case on the evidence in the record (220 ILCS 5/10-103, 10-201(e)(iv)(A)). Staff urges the Commission to consider the analysis Staff provided in this case. The Commission's reliance on Staff's analysis to reach a conclusion different than that made in the Companies' last rate cases would not be arbitrary or capricious.

Second, the PO does not address the fact that pass-through taxes are not revenue and as such cannot have a revenue lag. Neither Staff nor the Companies consider pass-through taxes to be revenues in this proceeding. PGL Ex. 7.0, p. 22; NS Ex. 7.0, p. 19 and ICC Staff Exhibit 1.0, p. 11. The PO's allowance of a revenue lag for pass-through taxes provides a revenue lag for something that the Companies themselves do not include as revenue in this proceeding.

Third, the PO fails to consider that because ratepayers provide the financing for pass-through taxes, allowance of a revenue lag for these taxes allows investors to earn a return on ratepayer provided funds. The PO's conclusion to include revenue lag for pass-through taxes only makes sense if one assumes that shareholders are making payments for pass-through taxes that have not been received from ratepayers. The

Companies' witness, Mr. Hengtgen, clearly lays out the number of days that the Companies could hold Energy Assistance Charges, Gross Receipts/Municipal Utility Tax and City of Chicago Gas Use Tax prior to remitting to the taxing authorities. NS-PGL Ex. 23.0 Corrected, p. 21. The Companies' analysis further confirms that the Companies do hold pass-through taxes prior to remitting to the taxing authorities. Mr. Hengtgen explains that, on the majority of pass-through taxes, the Companies are not required to remit pass-through taxes until after the taxes are collected from ratepayers. PGL Ex. 7.0, pp. 25 – 27; NS Ex. 7.0, pp. 23 – 24; NS-PGL Ex. 23.0 Corrected, p. 21. Pass-though tax remittance, as presented in Mr. Hengtgen's testimony, can be summarized as follows:

> <u>ICC Gas Revenue Taxes</u> are paid in four equal installments with a true-up payment due on March 15th of the year following. This pass-though tax is the exception and has a negative lead time.
>
> <u>Gross Receipts/Municipal Utility Taxes</u> are paid monthly based on estimated monthly collection percentages. In his rebuttal testimony, Mr. Hengtgen clarified that *the tax is due on the last day of the month following the month received*.
>
> <u>Energy Assistance Charges</u> are required to be paid monthly on the *20th day of the month following the month in which they are collected*.
>
> <u>IDOR Gas Revenue/Public Utility Taxes</u> are due and paid together on an estimated basis on the 7th, 14th, 21st, and 28th of the month with a true-up payment is due on the *15th of the following month*.
>
> <u>City of Chicago Gas Use Taxes</u> are the same as Gross Receipts/Municipal Utility Taxes but apply only to Peoples Gas.

Staff notes that the single prepaid pass-through tax, ICC Gas Revenue Tax, makes up less than 2% of total pass-through taxes for each company (Peoples Gas: 0.68% = $1,138,000/$167,973,000) (North Shore: 1.41% = $239,000/$16,900,000). PO Attachments, p. 11.

Staff's CWC methodology reflects the proper treatment of pass-through taxes in the CWC analysis. This includes setting revenue lags days to zero for pass-through taxes. For these reasons, Staff respectively requests that the Commission substitute the following language under "Commission Analysis and Conclusion":

Proposed Modification

(PO, p. 26)

Commission Analysis and Conclusion

> The Commission acknowledges that it approved the Utilities' expense leads and revenue lags in the 2009 rate cases. We found that the Utilities have ~~appropriately~~ used a methodology that matches what the Commission approved in their last rate cases ~~and rejected Staff's proposal~~. We also recognize that the terms upon which the Utilities remit taxes and charges have not changed since the 2009 rate cases. Staff acknowledges this as well. ~~The Commission again rejects Staff's proposal to change the cash working capital methodology for pass-through taxes.~~ <u>We find, however, that this is a factual question that rests on when a utility must make certain payments, such as taxes, and when it receives the cash from ratepayers to the make the payments. Whether the payments are based on estimated or actual cash receipts does not matter. If the Companies make a payment but the money has not yet been received from ratepayers, then this amount is appropriately considered in the calculation of cash working capital. Likewise, if money is collected and held on to prior to payment then that fact must also be considered in the calculation of cash working capital. Lead lag studies are the method by which this is determined. Staff has presented an analysis in this proceeding which leads the Commission to a conclusion that is consistent with the Commission's conclusion in recent rate cases of other utilities.</u>
>
> <u>Staff's proposal finds that the Utilities are, for the most part, holding customers' money for pass-through taxes which are later remitted to taxing authorities. Staff's approach properly considers the time between when customers are billed for pass through taxes, the receipt of the payment by the Utilities, and the length of time the payment is held by the Utilities until the pass through taxes are remitted to the taxing authorities. This same type of analysis was</u>

used by Staff in the three cited prior rate cases. We see no reason to deviate from that same general analysis here.

Accordingly, Staff's cash working capital methodology for pass-through taxes is accepted. In our view, based upon the analysis in the record, we agree with Staff's position to give pass-through taxes zero revenue lag time in the CWC calculation.

b. Prepayments (Uncontested)

c. All Other (Uncontested)

5. Retirement Benefits, Net

6. Accumulated Deferred Income Taxes –

D. Accumulated Depreciation (Uncontested Except for Derivative Adjustments from Contested Adjustments)

E. Approved Rate Base

V. OPERATING EXPENSES

A. Overview

B. Uncontested Issues

C. Contested Issues

1. Incentive Compensation

The PO does not provide a rationale for rejecting two of the three disallowance components of incentive compensation proposed by Staff. Those two disallowances proposed by Staff were: (1) 27% of the remaining plan which is based on the performance of NS and PGL affiliates, and (2) 50% of the balance which is tied to Integrys Energy Group's net income. PO, p. 50.

With respect to the component of incentive compensation that is based on the performance of affiliates of NS and PGL, the PO does not provide rationale as to why the revenue requirement should include incentive compensation based on the performance of utility affiliates in the current case when it was not allowed in the

Companies most recent prior case. Order, Docket No. 09-0166/0167, January 21, 2010, Appendix A, p. 12, line 8 and Appendix B, p. 10, line 8. As that Order stated:

> The Commission agrees with Staff that performance goals tied to the Utilities' affiliates do not benefit Illinois ratepayers. Accordingly, Staff's adjustments for affiliate performance are adopted. Order, Docket No. 09-0166/0167, January 21, 2010, p. 58.

The Companies explain that comprehensive programs provided at the corporate level reap benefits to all the affiliates and thus the costs of the incentive plan that may result from the programs should be borne by all the affiliates regardless of the benefit to each affiliate on a stand-alone basis. NS-PGL Ex. 25.0, pp. 6-7. However, the Companies have not indicated the level to which each affiliate benefitted from the various programs discussed. Staff IB, p. 25. Staff does not disagree that the cost of a comprehensive program that is utilized by each affiliate should be shared by all affiliates. Staff's concern is that the success other affiliates achieve under the program does not provide a benefit to NS and PGL ratepayers and thus the NS and PGL ratepayers should not bear the burden of the incentive compensation costs attributable to the performance of those affiliates.

With respect to the Integrys Energy Group's net income target, the PO likewise fails to explain what evidence was provided in the current case that would cause a different conclusion to be reached from that in the most recent prior case. Order, Docket No. 09-0166/0167, January 21, 2010, Appendix A, p. 12, line 9 and Appendix B, p. 10, line 9. The Companies argue that Integrys has consistently met its EPS targets and it is reasonable to expect that pattern to continue. NS-PGL Ex. 25.0, p. 8. Staff's concern is not so much whether the target will be met but rather that it ***must*** be met in order for the payout to not be decreased, thus tying payout again to a financial target. Staff Ex. 12.0 Corrected, p. 8. Since the PO accepted the adjustment that 70% of the Executive Incentive Plan's costs weighted on EPS criteria should be disallowed (PO, pp. 52-53), the costs associated with the criteria that the 50% of the payout is directly tied to the Integrys Energy Group's EPS target must also be disallowed.

Staff proposes the following changes to pages 52-53 of the PO's conclusion on this issue:

Proposed Modification

(PO, pp. 52-53)

Commission Analysis and Conclusion

> The Commission finds that the Utilities should not be allowed to recover all of their expenses related to the Executive Incentive Compensation Plan inasmuch as they fail to address the ratepayer benefit required by the Commission in prior cases for such costs to be recovered from ratepayers. The Commission agrees with both Staff and GCI in their adjustments finding that 70% of the Executive Incentive Plan's costs weighted on EPS criteria should be disallowed from rates. We ~~find, further, regarding~~ also accept Staff's additional adjustments of (1) 27% of the remaining Executive Plan expense that is an estimate of the performance goals that are based on the achievements of PGL and NS affiliates; and (2) 50% of the balance which is tied to Integrys Energy Group's net income ~~– that these additional adjustments sought by Staff are unwarranted. We agree with the Utilities that the comprehensive programs provided at the corporate level do reap benefits to all the affiliates and thus the costs of the incentive plan that may result from the programs should be borne by all the affiliates. As well, Integrys has consistently met its EPS targets which leads us to believe, at this point, an adjustment would not be warranted.~~ <u>because the Utilities failed to provide compelling reasons for the Commission to depart from its conclusion on these issues in the most recent rate cases (Docket Nos. 09-0166/0167, Cons.) for these utilities.</u>

In the event that the PO's conclusion on the Incentive Compensation expenses is approved in the final order, which it should not, certain corrections are necessary to the calculation of a revenue requirement for North Shore Gas Company on Appendix A, p.

3, column (g). The removal of Staff's proposed disallowances in Staff Exhibit 12.0, Schedule 12.2N, page 2, lines 7 and 8 as discussed in the PO would result in changes to the Administrative and General and Taxes Other Than Income expense lines. Appendix A., p.1 column (g), Line 13 for Administrative and General expense should be changed to $(932) and line 17 for Taxes Other Than Income should be changed to $(101). Staff agrees that the amounts for the Incentive Compensation expense adjustment for Peoples' Gas Company in Appendix B correctly reflect the PO's conclusion.

2. Non-union Base Wages

3. Headcounts

4. Self-Constructed Property

5. Uncollectibles Expenses – Use of Net Write-Off Method

6. Administrative & General

7. Depreciation

8. Revenues

a. Repair Revenues

b. Other Issues Relating to PEHS and PEPP, Including Staff Request for Investigation

Staff is fully supportive of the PO's conclusions and reasoning herein. Staff has raised concerns regarding which services are authorized in the recently approved Master Affiliated Interest Agreement document ("Master AIA") (Docket No. 10-0408) that will supersede the Services and Transfer Agreement ("STA"). Staff Ex. 9.0, pp. 34-35. Since there is a disagreement about the services that are authorized under Master AIA approved in Docket No. 10-0408 (*Id*., and Attachment G, p. 1), the Commission should investigate this matter and determine when the Master AIA should become effective and whether the Master AIA authorizes these services. In order to clarify the timing and sequence of the investigation, Staff respectfully recommends that the following language be added to the PO.

Proposed Modification

(PO, p. 96)

Commission Analysis and Conclusion

The Commission agrees with Staff and finds that the Utilities have not properly interacted with their affiliates as evidenced by our conclusions in the above related sections. Staff's proposal for further Commission investigation of the Utilities' interactions with their affiliates is warranted and in the public interest. We believe that the investigation is necessary to prevent ratepayers from continuing to subsidize the affiliates. On December 15, 2010, this Commission approved a Master Affiliated Interests Agreement (Master "AIA") by its Order in Docket No. 10-0408 that has not yet become effective. The Companies argue that the Services and Transfer Agreement ("STA") is still in effect and allows the Utilities to provide the solicitation services for the nonregulated affiliates; however, the language that specifically allows the provision of solicitation services is not included in the Master AIA. Since it is now clear that the Utilities intend to continue the provision of solicitation services even under the Master AIA when it becomes effective and the Commission finds that the Utilities have not properly interacted with their affiliates in the provision of services under the STA, it is necessary for the Commission to render a more direct conclusion on the provision of solicitation services to affiliates. Thus, the Utilities are required within 90 days of the Order in this case to file a petition and testimony demonstrating that the Utilities' affiliate interactions are in compliance with the STA and the Master AIA. Additionally, the petition and testimony must address any jurisdictional issues with the Master AIA agreement pending in Wisconsin. Finally this petition and testimony must ~~to~~ provide full cost justification for the repair rates charged to ratepayers as well.

c. Warranty Products (Revenue and Non Revenue)

D. Taxes Other Than Income Taxes (Payroll and Invested Capital Taxes) (Uncontested Except for Derivative Adjustments from Contested Adjustments)

E. Income Taxes (Including Interest Synchronization) (Uncontested Except for Derivative Adjustments from Contested Adjustments)

F. Gross Revenue Conversion Factor

G. Total Operating Expenses

VI. RATE OF RETURN

A. Overview

B. Capital Structure

C. Cost of Long-Term Debt

D. Cost of Short-Term Debt

E. Cost of Common Equity

The ALJ's Proposed Order adopts a cost of common equity of 8.85% for both North Shore and Peoples Gas. That ROE reflects the ALJ's rejection of the 10 basis point downward adjustment Staff recommended to the ROE it calculated for the Gas Group. The PO states that Staff's proposed adjustment was intended to reflect the reduction in risk associated with Rider ICR and concludes that since Rider ICR was rejected, the ROE adjustment is unnecessary. PO at 136. However, as correctly noted on page 124 of the PO, the 10-basis point adjustment Staff recommends to the Gas Group's ROE is not for Rider ICR, but rather, for Rider UEA. Thus, the rationale for the PO's rejection of the 10 basis point reduction is inapplicable. As Staff explained, Rider UEA reduces the volatility and uncertainty of cash flows, reducing the Companies' risk. Therefore, to estimate the cost of common equity for the Companies, Staff recommended that the Commission adjust the Gas Group's investor required rate of return downward 10 basis points to reflect the reduction in risk associated with Rider

UEA, which was authorized in the Companies' last rate case with the same 10 basis point adjustment. ICC Staff Ex. 5.0 Corrected, pp. 19-20. With a correction to the PO to reinstate that adjustment, the investor-required rate of return on common equity would be 8.75% for both North Shore and Peoples Gas. With corresponding changes to the weighted average cost of capital

Therefore the following changes need to be made to the ALJ's PO:

Proposed Modification

(PO, pp. 132-133)

The Utilities oppose Mr. McNally's recommendation to make a 10-basis point adjustment for Rider UEA. The Utilities argue that this additional adjustment is unnecessary because in their last rate cases, the Commission already made a ~~20~~<u>10</u> basis point adjustment for the fact that the legislation authorizing Rider UEA was enacted. *Peoples 2009*, pp. 128-129. Because Rider UEA has been in effect for the Utilities, there can be no change in their risk since their last rate cases. NS-PGL Ex. 19.0 REV at 24.

(PO, p. 136)

Staff averaged the results of its DCF analysis and the results of its CAPM analysis to obtain an ROE of 8.85% which it reduced to 8.75% because of an adjustment for Rider ~~ICR~~<u>UEA</u> similar to one made by the Commission in the Companies' last rate case.

***

Finally, it is necessary to address the Staff recommendation to reduce the return on common equity by 10 basis points to reflect the reduction in risk associated with Rider <u>UEA</u>~~ICR~~. ~~While t~~<u>T</u>his recommendation is reasonable ~~on its face~~ and consistent with the Commission's decision in the Utilities' last rate case~~, it is not appropriate to adopt it here~~. ~~In the recent decision in *Madigan,* the Appellate Court recently reversed the Commission's decision adopting and implementing Rider ICR. As a result, Rider ICR will be eliminated and no adjustment to the cost of equity is necessary~~. <u>The Companies' argument that the adjustment is unnecessary because the Commission made the same adjustment in the Companies' last case is illogical. The adjustment is not intended to accommodate a one-time change in risk of the Companies, but rather, to reflect the fact that the Companies have, and will continue to have, in place a risk-reducing rider. Thus, a 10 basis point downward adjustment is appropriate in this proceeding, for the same reasons the Commission found it appropriate in the Companies' last rate case.</u> The Commission concludes that the Utilities should be authorized to earn a return on common equity of ~~8.85~~<u>8.75</u>%.

F. Weighted Average Cost of Capital

Based upon the arguments made above in Section E, Staff recommends the following corresponding changes to the PO:

Proposed Modification for North Shore

(PO, p. 137)

	Proportion	Cost	Weighted Cost
Short Term Debt	3.90%	4.04%	0.16%
Long Term Debt	46.10%	5.51%	2.54%
Preferred Stock	0.00%	0.00%	0.00%
Common Stock	50.00%	8.~~85~~75%	4.~~43~~38%
TOTAL	100.00%		**7.~~13~~08%**

Proposed Modification for Peoples Gas

	Approved Rates of Return		
	Proportion	Cost	Weighted Cost
Short Term Debt	2.60%	2.62%	0.07%
Long Term Debt	48.40%	4.57%	2.21%
Preferred Stock	0.00%	0.00%	0.00%
Common Stock	49.00%	8.~~85~~75%	4.~~34~~29%
TOTAL	100.00%		**6.~~62~~57%**

VII. WEATHER NORMALIZATION (Uncontested)

VIII. RIDERS – NON-TRANSPORTATION

A. Riders UEA and UEA-GC

B. Rider VBA

Staff disagrees with the PO's conclusion to continue Rider VBA on a pilot basis and to hold workshops to tie Rider VBA to revenue losses from energy efficiency measures. PO, p. 160. Rider VBA has been in effect since 2008 and there is plenty of experience with the mechanics of the Rider. It has worked as it was intended by crediting or charging customers for any over or under recoveries of revenue. To date, the net effect of the reconciliations has been refunds to customers. When weather is less severe than normal, as it will be at some point, charges to customers will inevitably occur. There is little if anything to be learned by continuing Rider VBA as a pilot.

Although Rider VBA was originally intended to protect the Utilities from revenue losses caused by energy efficiency programs, there are additional benefits to ratepayers from Rider VBA. As Dr. Brightwell indicated in his testimony, Rider VBA reduces the reliance on forecasting customers and usage to set rates. Staff Exhibit 6.0, pp. 4-5. The forecasts are inevitably incorrect each year, and they are only correct on average. Rider VBA prevents harm to either the ratepayer or the utility from usage that deviates from the average. It also protects ratepayers in the event the utilities generate or choose a forecast that underestimates sales volumes. Id., at 9. Absent Rider VBA, such a forecast set rates too high and unjustifiably increases revenues and profits to the Utilities. Id. With Rider VBA, such a forecast is ineffective at increasing profits, because over collections are refunded to customers.

Rider VBA also diminishes the advantages that the utility has from choosing the timing of its next rate case. Id., at 5. Without Rider VBA, a forecast that does not account for sales growth leads to over collections. The Utilities have no incentive to petition for a change in rates because such a petition reduces their profits. However, a forecast over-estimating growth in sales causes the Utilities to under collect, and those Utilities have an incentive to file for an increase in rates. Since most rate cases are filed by the Utilities, this asymmetry is to the Utilities advantage and the ratepayer's detriment. Rider VBA diminishes the asymmetric risk and thus provides a benefit to ratepayers.

In the event the Commission agrees with Staff's recommendation to make Rider VBA permanent, there is no need to conduct workshops. Staff makes the following proposed modifications:

Proposed Modification

(PO, p. 160)

> In short, the conditions we anticipated four years ago when this pilot program was initiated, regarding the price of natural gas and lost sales revenues have failed to materialize. Commodity costs are substantially lower and mandated energy efficiency programs have thus far failed to significantly impact revenues. Utility costs and revenues continue to be dynamic and variable. Had the winters experienced in the service areas since the inception of the program been milder than projected, ratepayers would have faced surcharges. That ratepayers received credits for exceeding the overall projected consumption estimate due to colder than predicted winters confirms that there is a potential consumer benefit to Rider VBA vis a vis the Straight Fixed Variable ("SFV") rate design, assuming projected usage is accurately forecasted, which is unlikely to occur except on average. Staff also provided evidence that Rider VBA provides benefits to ratepayers through reducing the asymmetric risks associated with the Utilities choosing the timing of rate cases and that it is preferential to a SFV rate or other rate that increases the percentage of fixed costs recovered through fixed charges. ~~However, guaranteeing a specific revenue level from the Companies' volumetric sales should be linked to the public policy goals of conservation and energy efficiency.~~
>
> The Commission is ~~not~~ convinced that there has been a sufficient showing that a permanent Rider VBA is justified ~~in the absence of some concrete proposal from the Companies to tie revenue losses from the Companies' energy efficiency programs to the Rider. We direct the Companies and~~ interested ~~parties to use the workshop process before the Companies' next rate case to explore linking Rider VBA to that goal. In the interim this Commission directs that Rider VBA shall continue on a pilot basis. Subject to that limitation~~, ~~the Commission~~ and we approve~~s~~ the tariff changes as set forth in NS-PGL Ex. 45.5 and NS-PGL Ex. 45.6 except for those which provide consideration for customer switching between S.C.2, S.C. 3, and S.C. 4

If the Commission disagrees with Staff's recommendation to make Rider VBA permanent, Staff is also concerned with the PO's proposal to hold workshops designed to tie Rider VBA to revenue losses from energy efficiency. Staff opposes tying revenue adjustments to losses from specific projects or programs from the Utilities' energy efficiency programs. Staff is of the opinion that it is problematic to accurately quantify any losses such that they can be known and measurable. Additionally, to the extent that savings can be quantified, the savings are estimated through program evaluation that is completed more than a year after the savings occurred. In addition to difficulty with accurately measuring savings, Staff has limited resources to participate in these workshops.

There are several reasons that savings cannot be accurately quantified. First, experts disagree among themselves about how much gross savings occur. These disagreements primarily result from differences in opinion about what should be considered the baseline[1] and also from differences in modeling software procedures used for estimating savings. The discrepancies in measured savings across the Utilities in Illinois was among the reasons the Commission ordered the development of a statewide Technical Reference Manual in the most recent energy efficiency planning dockets. (See Final Orders in Dockets 10-0562, 10-0564, 10-0568, and 10-0570.)

[1] A baseline is needed to determine savings for a particular measure or project. In simplest cases this involves something such as Model A is the minimum efficiency water heater available that meets federal standards. A customer installs a more efficient model B. The difference in energy between model A and model B represents the savings from the water heater. In more complex cases there are energy systems or building envelopes that generate energy savings. In these cases one has to make assumptions about before and after conditions from a "typical" system or building. These assumptions can lead to vastly different estimated "savings." Even in the simple example of a measure such as the water heater listed above, it is not a simple as depicted. Suppose some percentage of customers would purchase a water heater more efficient than model A but less efficient than model B, then choosing model A as a baseline would overstate savings.

Second, lost revenues do not result from gross savings. They result from net savings. That is, savings that would not occur absent the Utilities' energy efficiency programs. Some customers who use incentives would purchase products even without the utility rebates, and other customers who purchased energy efficient products but did not receive utility incentives, made the purchases after learning about energy efficiency through word-of-mouth from program participants. Estimation of the net savings is highly speculative. A Commission report to the General Assembly reported that net savings from light bulbs ranged from 54 to 154% of gross savings in Ameren's territory and between 21 and 60% in Commonwealth Edison's territory depending on the modeling assumptions or methods used to calculate gross savings. (Report to the Illinois General Assembly Concerning Spending Limits on Energy Efficiency and Demand-Response, dated June 2011, p. 6.)

Third, even if the Commission did believe these savings can be accurately measured, there is no way to disentangle these savings from what is reflected in the test-year forecasts. The statistical forecast methods use information about building envelope and appliance saturation trends from both Illinois and other Midwestern states to estimate average use during the test-year. Many other Midwestern states have energy efficiency programs that are more mature and developed than those in Illinois. As a result, some incremental savings from the Utilities' programs may already be reflected in the test-year forecasts. Allowing the utility to recover revenues from such savings through a VBA that ties collection to energy efficiency losses allows the Utilities to over-recover the revenue requirement.

Fourth, the evaluation reports used to estimate net savings from the Utilities' programs credit an entire year's worth of savings to any measure or project completed within the year. For example, Program Year 1 is from June 1, 2011 through May 31, 2012. A measure installed on May 30, 2012 that saves 100 therms per year would be assumed to save the entire 100 therms in year 1 even though it was installed on the second-to-last day of the Program Year. Under such a scenario, the Utilities could claim lost revenues from 100 therms when it is most likely that less than one therm was saved by ratepayers during Program Year 1.

Finally, the evaluation reports are usually submitted several months after the Program Year is completed and Commission review of these reports commences at some point after these evaluations are submitted. Commission review of the electricity savings from Year 2 of ComEd's and Ameren's energy efficiency programs is now in progress. Program Year 2 ended on May 31, 2010. Tying Rider VBA to revenue losses from energy efficiency programs could mean refunds or charges occur almost two years after the Program Year is complete.

Staff recommends the following changes to the last two paragraphs of the PO's findings and conclusions:

Proposed Modification

(PO, p. 160)

> In short, the conditions we anticipated four years ago when this pilot program was initiated, regarding the price of natural gas and lost sales revenues have failed to materialize. Commodity costs are substantially lower and mandated energy efficiency programs have thus far failed to significantly impact revenues. Utility costs and revenues continue to be dynamic and variable. Had the winters experienced in the service areas since the inception of the program been milder than

> projected, ratepayers would have faced surcharges. That ratepayers received credits for exceeding the overall projected consumption estimate due to colder than predicted winters confirms that there is a potential consumer benefit to Rider VBA vis a vis the Straight Fixed Variable ("SFV") rate design, assuming projected usage is accurately forecasted, which is unlikely to occur except on average. Staff also provided evidence that Rider VBA provides benefits to ratepayers through reducing the asymmetric risks associated with the Utilities choosing the timing of rate cases and that it is preferential to a SFV rate or other rate that increases the percentage of fixed costs recovered through fixed charges. However, guaranteeing a specific revenue level from the Companies' volumetric sales should be linked to the public policy goals of conservation and energy efficiency.
>
> The Commission is not convinced that there has been a sufficient showing that a permanent Rider VBA is justified. ~~in the absence of some concrete proposal from the Companies to tie revenue losses from the Companies' energy efficiency programs to the Rider. We direct the Companies and~~ interested ~~parties to use the workshop process before the Companies' next rate case to explore linking Rider VBA to that goal. In the interim this Commission directs that Rider VBA shall continue on a pilot basis. Subject to that limitation~~, ~~the Commission and~~ We approves Rider VBA as an ongoing pilot with the tariff changes ~~as~~ set forth in NS-PGL Ex. 45.5 and NS-PGL Ex. 45.6 except for those which provide consideration for customer switching between S.C.2, S.C. 3, and S.C. 4

If the Commission disagrees with Staff's position and concludes that Rider VBA should not become permanent but rather should continue as a pilot, some language in the PO needs clarification as discussed below.

Staff recommends that the final concluding paragraph in the PO at page 160 on the issue of the continuation of Rider VBA needs clarification ("In the interim this Commission directs that Rider VBA shall continue on a pilot basis." PO, p. 160. The "interim period" stated for the continuation of Rider VBA on a pilot basis is unclear. In addition, the PO provides no direction as to what will take place at the end of the pilot Rider VBA program.

The PO states that “in the interim” “Rider VBA shall continue on a pilot basis”. It is unclear what time period is meant by “the interim.” The interim period could be interpreted in a number of ways: (1) to end in March 2012; (2) to end when new rates become effective from the next rate case; or (3) to the date of the anticipated appellate court decision. One could interpret the order to mean that Rider VBA would continue on an interim basis until March 2012 because as originally approved, the pilot program would end in March 2012. Since there is no discussion of extending the pilot period in the PO’s conclusion or in evidence in this case, one could interpret the interim to be through March 31, 2012. However, the sentence immediately preceding the direction of the Commission discusses a workshop to be held before the Companies’ next rate case. Thus, one could interpret the order to mean that the pilot would continue in the interim until rates resulting from the next rate cases would go into effect. And, based on the first sentence of the Commission Analysis and Conclusion on this issue beginning on page 158 discussing the legality of Rider VBA in the current appellate case, one could interpret the order to mean that the pilot would continue through the date of the order issued in that appeal.

Finally, Staff would note that there was no process approved for what happens at the end of the pilot program for Rider VBA to addressing any evaluation of the Rider, its operations, assumptions made, or the resolution of any remaining over or under recovery remaining at the end of the pilot period. Staff recommends that these issues also be included in the workshop process as directed in the language in the PO.

In the event the Commission's accepts the PO's conclusion regarding the status of Rider VBA, Staff proposes the following language changes to the second paragraph on page 160 for clarification:

Proposed Modification

(PO, p. 160)

> The Commission is not convinced that there has been a sufficient showing that a permanent Rider VBA is justified in the absence of some concrete proposal from the Companies to tie revenue losses from the Companies' energy efficiency programs to the Rider. We direct the Companies and interested parties to use the workshop process before the Companies' next rate case to explore linking Rider VBA to that goal <u>and to evaluate the Rider, its operations, assumptions made, or the resolution of any remaining over or under recovery remaining at the end of the pilot period.</u> In the interim this Commission directs that Rider VBA shall continue on a pilot basis <u>until (insert date as determined by the Commission)</u>. Subject to that limitation, the Commission approves the tariff changes as set forth in NS-PGL Ex. 45.5 and NS-PGL Ex. 45.6 except for those which provide consideration for customer switching between S.C.2, S.C. 3, and S.C. 4

C. Rider ICR

IX. COST OF SERVICE STUDY

X. RATE DESIGN

A. Overview

B. General Rate Design

C. Service Classification Rate Design

D. Tariffs – Other Non-Transportation Tariff Issues

1. Uncontested Issues - North Shore and Peoples Gas

a. Terms and Conditions of Service

For unknown reasons, the Utilities placed the Operational Flow Order ("OFO") "definition" in both the uncontested non-transportation tariff section of its initial brief and in the contested transportation issues section of its initial brief. Companies IB, p. 141; Id., pp. 151, 155 and 156, respectively. However, the OFO pertains to transportation suppliers only and the record is clear that Staff and intervenors do contest the need for any new restrictions for LVT service. Staff IB, pp. 126-127; IIEC/CNE-Gas RB, pp. 5 and 15, respectively. Apparently, the Utilities placement of the issue in the uncontested non-transportation tariff section of its initial brief has caused the ALJs to treat the issue as uncontested in some portions of the PO.

However, the PO as set forth below has numerous references to OFO issues that show there is a dispute between the Utilities, Staff and intervenors on the OFO issue.

> Staff alleges that the Companies have shown no cause for increased system concerns. The system has not been compromised because the Companies have the tariff's system protections. The tariffs currently have tools that enable the Companies to adequately manage the system and prevent compromise including declaring Critical Days ("CD") or invoking delivery restrictions. Staff Ex. 9.0, p. 13. The Companies claim that, "As a result of proper management, coordination with upstream pipelines, and by imposing limits on allowed deliveries the Company has been able to keep its system from being compromised." Companies' responses to Staff DR DAS 3.03d. Mr. Sackett points out that protecting against potential harm can result in unwarranted restrictions, which reduces transportation customers' options because they become unnecessarily constrained. Staff Ex. 9.0, p. 14.
>
> PO, pp. 206-7.

These delivery restrictions referenced by Staff witness Sackett are set forth in the Utilities' tariffs (ILL. C. C. NO. 28 Fourth Revised Sheet No. 20), and they provide adequate ability for the Utilities to manage system issues without the declaration of a CD. Staff Ex. 9.0, p. 13. In particular the following language in both the existing and proposed tariffs provide the Utilities with strong tools in times of duress:

TERMS AND CONDITIONS OF SERVICE

*** * ***

Operational Integrity and Delivery Restrictions

> In order to maintain the safe, efficient, and cost effective operation of its system, the Company, on any Gas Day, may, but shall not be obligated to, specify the quantity of gas that it shall accept at one or more of its citygate stations or specify the total quantity of gas that an entity may deliver to its system, and such specification may be stated in any reasonable manner, including as a specific percentage or other cap on increa.ses from prior Gas Day's deliveries. Each entity delivering gas to the Company's system is responsible for adhering to such specifications. The Company shall not invoke this Operational Integrity and Delivery Restrictions provision for economic reasons, and shall provide a two-hour minimum notice of such specifications prior to any applicable nomination deadlines. This Operational Integrity and Delivery Restrictions provision shall be applied to all entities in a nondiscriminatory manner. If an entity delivering gas requests to deliver gas in excess of a delivery restriction, the Company shall use reasonable efforts to adjust, on a non-discriminatory basis, the applicable restriction to allow the entity to deliver sufficient gas to meet the expected usage of customers served by the delivering entity and taking into account usage (deliveries to and from) those customers' gas bank accounts. Nothing in this paragraph shall prevent the Company from unilaterally taking actions, in addition to or in lieu of specifying delivery requirements at citygate stations, as may be necessary to maintain system pressure and preserve the integrity of its system.

* * *

Peoples Gas Light and Coke Company - ILL. C. C. NO. 28, Fifth Revised Sheet No. 20 (Cancelling Fourth Revised Sheet No. 20; North Shore Gas Company - ILL. C. C. NO. 17, Sixth Revised Sheet No. 19 (Cancelling Fifth Revised Sheet No. 19).

IIEC/CNEG has made numerous objections to the institution of the OFO. PO, p. 191.

> In IIEC/CNEG's opinion, however, the Companies have not demonstrated that they have been unable to stay within or return to their normal operating plans without similar restrictions in current tariffs. The Companies have not adequately justified a need to declare operating restrictions for OFO days. The Companies have failed to provide concrete examples of when or why the OFO declaration is necessary.

PO, p. 219.

Based upon the above, it is not appropriate to place this issue in the uncontested portion of the PO. The issue belongs in the contested portion of transportation issues, XI.,D.,2.,d. and the Companies' position to create OFO days and associated restrictions and penalties should be rejected for the reasons set forth above and in Staff and Intervenors briefs.

Proposed Modification

(PO, p. 185)

X. Rate Design

* * *

D. Tariffs – Other Non-Transportation Tariff Issues

1. Uncontested Issues - North Shore and Peoples Gas

a) Terms and Conditions of Service

The Utilities proposed to move, but not change, the definition of Critical Days from Rider SST to the Terms and Conditions of Service. ~~The Utilities also proposed a new definition, Operational Flow Order ("OFO") Day, that would be included in the Terms and Conditions of Service.~~ NS Ex. 12.0 REV at 27-28; PGL Ex. 12.0 REV at 30.

Staff witness Harden reviewed the documentation that the Companies provided and found the support to be an acceptable basis for the proposed tariff changes to the charges listed above. Ms. Harden recommended that the Commission approve all aspects of the Companies' proposals to increase the Service Activation Charges and the Reconnection Charges. Staff Ex. 7.0, p. 37.

The Commission ~~approves as reasonable the definition of the term "OFO" and it~~ finds that proposal to move certain terms from the transportation riders to the Terms and Conditions of Service is reasonable and approves those changes.

b. **Service Activation Charges**

c. **Service Reconnection Charges**

d. **Rider 2**

e. **Rider 9**

E. **Bill Impacts**

XI. Transportation Issues

A. **Overview**

B. **Uncontested Issues**

C. **Administrative Charges**

D. **Large Volume Transportation Program**

1. **Administrative Charges**

2. **Transportation Storage – Issues**

For the reasons listed in X.,D.,1.,a., the Commission should adopt clear language expressly rejecting all the Utilities proposed tariff restrictions, including the OFO proposal.

Proposed Modification
(PO, pp. 216-217)

* * *

d) Commission Analysis and Conclusion

> Staff and IIEC/CNEG clearly disagree with the Utilities' proposals that go beyond unbundling the Rider SST bank from standby service. Staff and IIEC/CNEG maintain that the Utilities' additional proposals of: (1) a stand-alone storage banking service under which customers select the amount of storage capacity, (2) monthly inventory targets with monthly cashouts, (3) daily injection and withdrawal limits with daily cashouts, (4) daily tolerance around the daily ranges and (5) eliminate the no-notice standby service, clearly are not necessary to accomplish the goal of unbundling Rider SST from standby service. We agree with Staff and IIEC/CNEG and find that Rider SST is a functional LVT Service with the flaw of having the storage access and standby linked. There is no need to alter the service. The aim of unbundling the storage services from

standby service is to increase flexibility for transportation customers by retaining the full flexibility currently in the Rider SST tariff and giving those customers an option to select the size of the bank independent of the level of standby. The Utilities' additional proposals reduce daily and monthly flexibility. As mentioned, the only proposal which received universal support at the workshop was the recommendation to unbundle the Rider SST bank from standby service and the Utilities' go far beyond this. Further, such attempts to make these proposed changes to LVT programs have been rejected by the Commission in prior dockets. The Commission concludes that the Utilities have not demonstrated the need for their proposed monthly storage limits, ~~and~~ daily delivery restrictions, Operational Flow Order definition and associated restrictions and that the only parameter that should be changed is the Critical Day withdrawal amount pursuant to Staff witness Sackett's proposal.

3. Administrative Charges

4. Transportation Storage – Issues

5. Associated Rider Modifications

a. Rider SBS/SST

b. Rider FST

For the reasons listed in X.,D.,1.,a., the Commission conclusion should clarify that additional OFO restrictions proposed by the utilities are not supported by the record and not approved.

Proposed Modification

(PO, p. 223)

(3) Commission Analysis and Conclusion

The Commission agrees with Staff and IIEC/CNEG and rejects the Supply Shortage Day delivery requirement for Rider FST. The Utilities have argued that the analytical framework that applies to SBS should apply to FST and propose to add certain restrictions on to Rider FST to keep it in line with their proposals for SBS parameters. In line with our decision regarding Rider SBS/SST, we find that the restriction of the ability to withdraw gas on any day ~~OFO Supply Shortage Day or Critical Day~~

~~Supply Shortage Day~~ is an inappropriate reduction of the standby rights that transportation customers have for access to system gas.

c. Rider P

d. Rider SSC

e. Transition Riders

E. Small Volume Transportation Program (Choices for You^{SM} or "CFY")

XII. CONCLUSION

Staff respectfully requests that the Illinois Commerce Commission approve Staff's recommendations in this consolidated docket.

Respectfully submitted,

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